

September 16, 2016

VIA ELECTRONIC MAIL  
regs.comments@federalreserve.gov

Robert deV. Frierson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW.  
Washington, DC 20551

Re: Docket No. R-1539; RIN 7100 AE 53

Dear Mr. Frierson:

First American Financial Corporation ("FAF") welcomes the opportunity to comment on the advance notice of proposed rulemaking (the "ANPR") issued by the Board of Governors of the Federal Reserve System (the "Board") regarding approaches to regulatory capital requirements for depository institution holding companies significantly engaged in insurance activities ("IDIHCs"). 81 F.R. 38631 (2016).

#### Executive Summary

FAF is the only IDIHC primarily engaged in title insurance. Title insurance presents fundamentally different risks than the risks presented by property and casualty ("P&C"), health, life and other types of insurance (collectively, "Other Insurance") and that the ANPR is intended to address. These fundamental differences include among other things:

- Title insurance involves risk elimination, whereas Other Insurance involves risk assumption or risk spreading, which assumed risks are the types of risks raised in the ANPR.
- Title insurance involves low loss and high cost ratios while Other Insurance ratios are just the opposite, with high loss risk that cannot be prevented by extensive underwriting, which is the exposure the ANPR has in mind.
- Title insurance presents little risk of single major or aggregated losses, which again is the type of destabilizing exposure the ANPR is intended to deal with.

State insurance statutes and regulations already impose statutory premium reserve ("SPR") requirements that are unique to title insurers, which SPR addresses risks the ANPR raises. Also, the National Association of Insurance Commissioners ("NAIC")<sup>1</sup> has adopted risk-based capital ("RBC") requirements similar to the capital requirements contemplated by the

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<sup>1</sup> As the Board is aware, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight.

ANPR for Other Insurance, but considered and declined to adopt RBC requirements for title insurers for several reasons that are equally applicable to any requirement that might be considered by the Board in the case of title insurance.

Any rule adopted by the Board would need to contemplate the unique nature of title insurance and, moreover, the unique reserving requirements imposed on title insurers by its regulators. Given the comprehensive state-based regulatory regime to which FAF is subject and the relatively small role it – and for that matter the entire title insurance industry – plays in the greater economy, the costs of formulating such a rule and the burden of implementing clearly outweigh the benefits. Accordingly, and in response to Questions 2 and 3 of the ANPR, we respectfully recommend that any proposed rulemaking resulting from the ANPR exempt IDIHCs primarily engaged in the title insurance business.

### Discussion

#### 1. About FAF

FAF is the top tier parent of First American Title Insurance Company ("FATICO") and First American Trust, FSB ("FATFSB"), among other regulated and unregulated subsidiaries, and is a grandfathered savings and loan holding company subject to regulation by the Board. FAF traces its history back to 1889, during which time FAF and its subsidiaries have remained financially sound through even the most severe financial downturns, including the Great Depression and the more recent Great Recession. FAF is among the smallest of the IDIHCs, with revenue of approximately \$5 billion for the year ended December 31, 2015.

As noted above, FAF is the only IDIHC that is engaged primarily in the business of title insurance through FATICO and its affiliates, and FATICO is a leading provider of title insurance.

FATFSB is a well-capitalized federal savings bank regulated by the Office of the Comptroller of the Currency ("OCC"). FATFSB provides trust and investment advisory services to its clients and also provides significant depository and other banking services to FATICO and its affiliates associated with title insurance, escrow services and related transactions. FATFSB does not make loans to or accept deposits directly from consumers.

#### 2. Title Insurance, and Why Capital Requirements Contemplated by the ANPR Are Inappropriate

##### A. Overview of Title Insurance

Title insurers issue policies that primarily insure the condition of title to real property as it actually exists on the date of policy issuance. Other Insurance policies in contrast generally provide coverage with respect to events that may or may not occur in the future (or with respect to the timing of future events).

Specifically, title examinations conducted as part of the title insurance underwriting process are driven by the unique circumstances associated with the insured title, and underwriters

conduct the analysis of which defects or other risks need to be cured.<sup>2</sup> The essential goal of the underwriting process therefore is to eliminate risk. Other Insurance involves risks that cannot be eliminated and instead are assumed by the insurer, and the insurer models such risks and maintains levels of capital based on its modeling, which capital is intended to absorb such unpreventable risks.

Any defects in title discovered during the title search that the insured does not wish to appear as exceptions to the policy must be eliminated prior to issuance of the policy. Unlike Other Insurance, title insurers seldom insure against any uncertain or unknowable risk that a future event might occur (or the timing of a future event) that could result in a loss, such as the risks of “morbidity, mortality, longevity, [and] natural and man-made catastrophes” that are expressly cited as examples of insurance risks in the ANPR. 81 F.R. at 38631.

In short, title insurance is a risk elimination product, providing protection for any mistakes made in the underwriting process and any other covered causes of loss, whereas Other Insurance is a risk assumption product, providing coverage for risks that cannot be prevented even with the most diligent underwriting. As a result, title insurance does not give rise to the types of unpreventable and unpredictable risks that the sort of additional capital contemplated by the ANPR would address. In particular, the risks covered by a title insurer do not present any “threats to financial stability” of the overall economy.

B. Contemplated ANPR Capital Requirements Are Inappropriate for Title Insurance

Although as an advance notice of proposed rulemaking the ANPR properly does not propose specific capital requirements, it is clear that any capital requirements under either of the two approaches discussed in the ANPR would be wholly inappropriate for title insurance, given its nature as described above:

i. Differences in Loss and Cost Ratios Indicate Increased Capital Is Not Appropriate. Title insurer loss ratios generally run between 4% and 13% of the premium, whereas loss ratios for P&C insurers are typically between 65 to 85% of the premium.<sup>3</sup> Also, title insurer cost ratios run up to 85% to 95% of the premium, and are much lower for P&C insurance, which instead are in the range of 20% to 30%.<sup>4</sup> These starkly different ratios confirm the different nature of title insurance. That is, the high cost ratio of title insurance reflects the substantial underwriting and other work performed by the title insurer to prevent or eliminate risk or cure title defects discovered during the underwriting process. The low loss ratio similarly reflects the fact that title insurance does not insure against unpredictable risks, and if underwriting is properly performed losses should be extremely low.

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<sup>2</sup> A title insurer utilizes an extremely rigorous search during the underwriting of a policy to discover, disclose and mitigate these defects before issuing a policy, which process is detail intensive, transaction-specific and resistant to full automation.

<sup>3</sup> “Rating Title Insurance Companies,” A.M. Best Methodology, A.M. Best Rating Services, Inc., August 3, 2016, p. 2.

<sup>4</sup> Id.

These differences further indicate why any of the regulatory capital schemes contemplated by the ANPR would be inappropriate and indeed an unnecessary burden on title insurers. That is, the low level of losses demonstrates that no additional regulatory capital is needed in the case of title insurance to enhance the safety and soundness of an insurer. In addition, the high cost ratio shows that the way losses are addressed is by the performance of high quality underwriting to eliminate losses, not by adding additional capital for losses that can be prevented by strong underwriting.

ii. Title Insurance Does Not Present Risk of Major Losses Where Additional Capital May Be Advisable. The policy limit on a title policy is generally based on the purchase price or the size of the mortgage on the property. A title policy requires the insurer to deliver title as insured in the policy. This typically means only paying to cure any defect in title (e.g., buying a previously-unidentified easement from a neighbor) or paying the insured the diminution in value to the title. As a result, the vast majority of title insurance losses are less than policy limits.

Also, title insurance generally is not subject to the types of aggregated and often concentrated loss exposures that arise in connection with storms or other natural or man-made catastrophic events. Each title insurance policy covers a separate chain of title, with separate ownership and conditions, so a single catastrophic event is extremely unlikely to result in covered losses across multiple policies.

These differences likewise show that additional capital of the type contemplated by the ANPR is unnecessary in the case of title insurance. That is, because losses on title policies typically are not large nor aggregated, a title insurer does not face the sorts of massive, unexpected risks that may be addressed by additional capital of the types contemplated by the ANPR.

3. State Regulators Have Already Adopted Reserve Requirements for Title Insurers That Address Concerns Raised in the ANPR

Based on the foregoing unique aspects of title insurance, state legislatures and regulators have adopted statutory liability requirements for title insurers known as the statutory premium reserve ("SPR"). The amounts of these reserves are prescribed by state law, which require a specified percentage of premium or liability to be set aside at the time the policy is issued. Because of the small losses typically experienced by title insurers as discussed above, the calculation usually results in SPRs that exceed actuarially determined "incurred but not reported losses" or "IBNR" and therefore provides more than adequate protection.

These conservative SPR requirements are sometimes referred to by regulators as a "reinsurance reserve," meaning if the title insurer were to face severe financial stress, the SPR funds could be used to purchase reinsurance covering the tail of loss exposures. In other words, SPR is not necessarily the equivalent of other forms of reserves set aside by Other Insurance companies to pay future claims, and instead SPRs are funds set aside for unforeseeable negative events that might impact the continued viability of a title insurer. This is exactly the purpose of the capital requirements being considered by the ANPR, and it underscores why for IDIHCs

primarily engaged in the business of title insurance the additional layer of regulation contemplated by the ANPR is not only undesirable but unnecessary.

4. The NAIC Previously Considered and Rejected Risk-Based Capital Requirements for Title Insurers

Although again the ANPR does not propose specific capital requirements, the capital requirements contemplated by either approach under the ANPR are in the nature of RBC (i.e., risk-based capital) requirements. The NAIC has adopted different mechanisms and formulae to calculate RBC for each of type of Other Insurance. However, although an RBC model for title insurers has previously been discussed by the NAIC, it is our understanding that the NAIC abandoned any attempt to develop and apply such a formula to title insurers and concluded that existing SPR is the appropriate metric to protect title insurers, for the following reasons:

- The fundamental differences in the nature of the covered risks as discussed above.
- The inability to adequately value or risk-weight SPR (complicated by the fact that the calculation of the SPR is not necessarily uniform from state-to-state) or other state driven reserving requirements for title insurance.
- The inability to adequately value or risk-weight title plants, which contain the data critical to the underwriting of certain title insurance policies and are therefore important assets for the ongoing operations of a title insurance company.
- The non-systemic nature of title insurance risk.
- The dearth of significant data necessary to develop credible risk factors.
- Initial research that indicated that factors other than balance sheet weakness are the primary cause of title insurer failures.

Many of the foregoing factors would likewise apply to any attempt by the Board to establish an appropriate regulatory capital requirement for title insurers. Accordingly, the Board, similar to the approach taken by the NAIC, should exempt title insurers from any rulemaking proposed as a result of the ANPR.

Finally, because a quantitative capital method is not applicable to title insurers under state law, the Board would need to create a rule specifically for a single insurer. Given that this insurer is not a systemically important financial institution, and therefore presents no system risk to the overall economy, we believe the cost in time and resources to create such a rule would outweigh any benefits.

Conclusion

In sum, the capital requirements contemplated by either approach under the ANPR are intended to address risks simply not presented by title insurance. Indeed, the NAIC previously considered adopting RBC capital requirements for title insurance, as it has done for Other Insurance, and concluded that such requirements were not needed or workable for several reasons, many of which reasons are equally applicable to the capital requirements suggested in the ANPR. In addition, title insurers are already subject to SPR requirements, which address risks that are at issue in the ANPR. Also, developing a tailored regulatory capital rule for a



single title insurer would not appear to be the best use of the Board's resources. Accordingly, an exemption should be granted to IDIHCs primarily engaged in the title insurance business.

We thank the Board in advance for its consideration of our comments. FAF would be happy to provide the Board with additional information regarding the unique nature of title insurance and why an exemption for title insurers from any rulemaking should be provided.

Very truly yours,



Jeffrey S. Robinson  
VP, Secretary and Deputy General Counsel